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Regulation of Corporate Groups´ Governance

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1. INTRODUCTION

The topic of this master thesis is the need to regulate Corporate Groups at a national and international level, especially concerning the issues related with the corporate governance of these important economic operators.

The choice of this topic fulfills my aspiration to evaluate the role of the Corporate Groups in the current economic reality. Actually, Corporate Groups have greater significance and importance in the national and international markets, and the current largest businesses are huge holdings that operate over the world under a whole group structure. In spite of this reality, the current corporate legislation of the majority of the countries has not been updated in order to handle with this new scenario.

This gap between Law and reality is highlighted in particular when economic and legal problems rise by Corporate Groups, as has been demonstrated by the current crisis. In this context, the necessity of an efficient regulation of corporate governance is also evidenced.

Actually, there have been several attempts to regulate Corporate Groups, in particular in the European Union. These attempts failed. Additionally, regarding corporate governance, auto-regulation has shown its shortcomings to deal with and protect all the interests involved in the market.

Against this background, an effective regulation concerning Corporate Groups, giving particular emphasis to the corporate governance issues appears as an urgent subject that must be addressed.

The intention of this master thesis is present a general overview about the concept of Corporate Groups, their treatment by some countries and the European Union, as well as the concept of corporate governance and its general current treatment. Throughout this presentation, the problems and improvable aspects of these concepts will be exposed and connected. In this way, the relation between the need to regulate Corporate Groups and to regulate corporate governance will be showing, trying to find a valid solution that conjugates all the issues involved in those figures, and provide a higher legal certainty.

2. GENERAL REGULATION OF CORPORATE GROUPS

2.1. General Considerations

2.1.1. Concept of Corporate Group.

In general, according to the majority of the doctrine of different countries, a Corporate Group can be defined as an organization of different and legally independent companies under a unitary economic direction that may also operate under an identifiable corporate image. However, Corporate Group is not a legal entity itself. Actually, the dualism of unit of decision vs. plurality of companies causes several legal issues and conflicts that will be duly pointed out hereunder.

Corporate Groups are the privileged method of business concentration of the legal operators in order to achieve an optimum corporate size and deal with the competitiveness of the market, particularly in the case of large public limited companies. Moreover, international Corporate Groups appear as the best solution for several companies that want to operate in several countries with different legal and economic structure.

It must be pointed out that there is not neither a unique definition of Corporate Group, nor a legal one, because Corporate Groups can be formed through several combinations, such as holdings, related companies or parent and subsidiary companies.[1] Nevertheless, we may consider that the core elements of any definition of Corporate Groups are the following:[2] (i) legal entity; and (ii) unitary economic direction.

The element "legal entity" should be considered as a core element because each company of the group maintains, at least legally, its independence particularly with regard to its corporate bodies and estate. Consequently, from a strict legal perspective, each company of the group acts on its own name before their clients, employees, creditors, administrative authorities, etc. In this sense, in principle there are not neither "group´s creditors" nor "group´s debtors".

However, the essential element is the second one. In fact, a group of companies only exists if its members are subject both to a unitary direction and to a general strategy

[1] STRASSER, Kurt, *Legal Models and Business Realities of Enterprise Groups*. Pg 4-5
[2] PAZ-ARES, Cándido, *Uniones de empresas y grupos de sociedades*. pg. 622.

defined by the leader of the group. The unitary economic direction involves a common enterprise policy of the group that may affect one or more elements of the activity of each company (production policy, commercial policy, human resources policy). The different level of integration of the policies of the members results in different types of Corporate Groups (*see below*).

Nevertheless, the existence of a common financial organization (capital requirements, dividends and reservation policies, distribution of resources, etc.)[3] is pointed out as the minimal level of integration and unit of decision required so that a network of companies may be considered a Corporate Group. The existence of control (or its absence) will only affect the typology of the group but not its existence.

2.1.2. Reasons to form a group

Usually, the formation of a group results from an economic concentration process (vertical or horizontal) developed over a certain period of time. However, Corporate Groups may also result from the segregation of assets or by the incorporation of new companies with the purpose to diversify the corporate business activity. This being said, we may point out that the main reason to form a group is the rationalization of a certain economic structure with the purpose to respond to market demands over the time.

This response may be focused on diversifying insolvency risks (in principle, the insolvency of one company will not prevent the other companies of the group from keeping doing their business on a normal basis), geographical risks (risks related to local economies and political atmospheres), etc. Other relevant reason is the level of specialization required in the production of certain products, activities and services; in these cases, the Corporate Group may provide the conditions to have a more flexible and decentralized administration *inter alia* with the purpose to be near of the relevant interest center.

Other financial reasons may be related to the attraction of capital without losing the control of the main activity of the company (e.g. a subsidiary can be incorporated together with other minority shareholders) or the necessity of grating additional securities and guaranties to obtain bank financing or come up with a project finance.

[3] RAMÍREZ OTERO, Lorena, *El control y los grupos de sociedades.* pg. 629-631.

Regulatory reasons also can induce to the formation of a group (for example, to make possibly to carry out some regulated activities). On the other hand, in multinational Corporate Groups, the necessity of complying with several and different local legal regimes usually leads to the incorporation of a group.[4]

Despite Corporate Groups have led to abuses in some cases, the main and true reason to form a group is not necessarily to overthrow creditors, minority shareholders or regulators. As referred above, the issue is the necessity of a regulation that deals with the formation of groups and its undertaking in a modern and effective way, according to the current economic reality.

2.1.3. Types of Groups

As mentioned above, there are different types of Corporate Groups depending on the origin and nature of the group. Therefore, we may highlight the following categories:

(i) *De Jure groups vs. De facto group*[5]

De Jure Groups are incorporated according to the relevant proceedings expressly set out in Law (for example, a group contract). Therefore, both the organization and the internal relationships of the group are automatically regulated by specific provisions set out in the General Corporate Law.

By contrast, *De facto* groups are not formally formed as a Corporate Group, but they actually behave as a group, due to the existence of majority shareholders, shareholders agreements, personal unions, etc… With some exemptions (like, for example, Germany), domestic laws do not have any legal provision on the organization of the *de facto* groups, but doctrine and jurisprudence of different countries have dealt with this issue during the last century (*see below*).

(ii) *Control Groups, Contractual Groups and Personal Groups*[6]

[4] MCCOURT, Alison, *A comparative study of the doctrine of Corporate Groups with special emphasis on insolvency*, pg. 2.
[5] Classification based on the German and Portuguese Model, which legally recognized and define this classification of Corporate Groups.
[6] Classification based on the origin/cause of the Group. PAZ-ARES, *Supra 2*. pg. 624.

Control Groups have a main company that manages or has the power to manage, direct or indirectly, the other companies of the group. Control Groups are considered Vertical Groups (*see below*).

The existence of control is presumed in the following situations:[7] a) when the dominant company possesses the majority of the voting rights of the dependent/subordinate company; b) when the dominant company has the power to appoint or remove the directors of the dependent company; c) when the dominant company is able to obtain the majority of the voting rights in the dependent company through agreements with third parties; and d) when the dominant company has appointed the majority of the members of the Board of Directors of the dependent company. In particular, the control will be presumed when the majority of the members of the Board of Directors of the dependent company overlaps with the members of the Board of Directors of the dominant company, or with the members of another dependent's Board of Directors controlled by the dominant company.

In the case of Contractual Groups, the unitary direction of the group is originated by contractual relationships between the main company and the dependents. These contractual relationships are very heterogeneous (for example, operational leasing services contract or enterprise management contract). Contractual Groups are considered Horizontal Groups (*see below*).

Finally, Personal Groups are based on personal relationships. The unitary direction of the group exists due to the overlapping of the companies' directors. Usually, this overlapping are related either to financial or familiar reasons.

(iii) *Centralized Groups and Decentralized Groups*

The number of competences that the leading company assumes in the group determines either the existence of a Centralized Group or a Decentralized Group.

In this sense, in a centralized group the leading company manages all the competences of the other companies of the group leaving them without autonomy.

[7] PAZ-ARES, *Supra 2,* pg. 624: Concept of control following the presumptions established in the Section 42 of the Spanish Commercial Code.

In a decentralized group the leading company only exercises the powers concerning the management of the group but it respects the autonomy of the subsidiaries with regard to the management of their own business (for example, concerning production or marketing). In this type of groups, the unit of decision is just applied in those issues that concern the entire group as a whole. Obviously, there is a minimum of decisions that must be taken under the concept of "unit of decision" so that we may consider that the group exists.

This distinction is very relevant for the legal regime of the groups, particularly to establish an appropriate regulation for each case.[8]

(iv) *Vertical Groups and Horizontal Groups*

On one hand, Vertical or Subordinated Groups have a main or dominant company that controls the other of companies of the group (subsidiaries). There is a hierarchical relationship between the different companies of the group. This type of group has been more regulated by the Law and studied by the doctrine than the other types. Actually, the majority of the issues related to Corporate Groups are connected with this type of group. Vertical groups are usually are under the suspicion because it is likely that the subsidiaries act in interest of the dominant company instead of acting in interest of the group as a whole, particularly because the companies of this type of groups usually share and transfer assets and debts between them according to the most favorable tax and accounting regime, or use some companies of the group to allocate them the losses of the dominant company despite this fact may be inconvenient for the whole group.

On the other hand, Horizontal or Coordinated Groups have a parity structure, established either by means of a shareholders agreement or a Corporate Group Contract.[9] Each company of the group maintains its own independency and participates in the decision-making process in order to achieve a common policy. Sometimes, this type of groups has a higher decision body (composed by representatives of each company of the group) that has power to coordinate the common activities of the group. Therefore, the existence of a Corporate Group does not necessarily require a dominant

[8] EMBID IRUJO, José Miguel, *El significado jurídico de los grupos de sociedades. La corporate governance*. pg 87. This typology involves a basic perspective to interpret and apply the legal rules concerning Corporate Groups. Although it is true that the distinction between centralized and decentralized groups in the practice is not very clear.

[9] Based on the German Regime, which legally recognizes this type of Corporate Groups.

company. Actually, this typology of groups has been less analyzed by doctrine and jurisprudence (even in Germany, unless this typology is recognized in *Aktiengesetz*), because there is a common understanding that, in this case, the level of protection required is lower than in the case of Vertical Groups.[10] Nevertheless, this typology is without any doubt a legitimate type of Corporate Group, provided that exists a unitary decision-making body for the whole group.

- *Unit of decision vs. Control*

As referred above in this section, there is a risk to restrict the concept of "Corporate Group" to the mere situation of control and, therefore, other type of groups may be left without any protection, particularly the horizontal groups.[11] In this way, doctrine of all countries pays much more attention to control groups than to contractual or familiar groups. Consequently, it may create confusion about when we actually have a Corporate Group. For this reason, it is important to point out that the main element of a group is not the control of one company over another company. In fact, the main element is the unitary decision-making process for the group as a whole. The way to develop and implement this process may vary from case to case depending on the type of group we deal with. This unitary management must be continued, planned and stable.[12]

The existence of control relationship between some companies can be a presumption that a Corporate Group exists with a unitary decision-making process; but a group can also exit when there is a cooperation relationship between some companies that reduces the autonomy of each company of the group to organize its own management and business. In these cases, as it is pointed out in the previous section above, the unitary management of the group is done in a horizontal way.

2.1.4. Lack of regulation of Corporate Groups

The gap between the legal system and the economic reality of the Corporate Groups was already pointed out above. This gap results from the fact that Corporate Law has been traditionally configured for independent companies with autonomous governance

[10] EMBID IRUJO, José Miguel, *Ante la regulación de los grupos de sociedades en España*, pg 9.
[11] RAMÍREZ OTERO, *Supra 3*, pg 632.
[12] SANCHEZ – CALERO, Francisco Javier, *De nuevo sobre la regulación de los grupos de sociedades*, pg 21. The author indicates that the Unitary Management is not performed with one only measure in a concrete moment, such as the appointment of one administrator. Unitary Management consists in a permanent management.

bodies and focused on its particular interests. This traditional regime did not change when Corporate Groups appeared and proliferated in local and international economies. Until now, both the doctrine and the jurisprudence of the majority of the countries have been closing and solving such legal gaps. In fact, only Germany and Portugal have developed a specific legal regime for Corporate Groups. Other European countries have not enacted a proper regime for Corporate Groups in order to deal with the economic relevance of this issue. Although there are some proposals of legislation, these proposals did not become statutory Law yet.

Additionally, groups affect several different legal protected interests that are regulated by different areas of Law (such as Tax, Labor Law, securities and Antitrust Law). Consequently, there are several different approaches to the concept and nature of Corporate Group that may cause some confusion about Corporate Groups. In order to avoid any confusion or doubts, it would be advisable to agree on a general and common regulation on Corporate Groups. However, we are aware that is difficult to achieve this goal.[13]

Corporate Groups need a specific regulation that covers the several particularities of this reality. Despite this regulation should be found within Corporate Law area, it needs a treatment independent of the general corporate rules in order to deal with the specific issues of Corporate Groups in a proper way. Nevertheless, as referred above, Corporate Groups touch other areas of the legal system.[14] Therefore, certain provisions of other legal subjects must be taken into account in order to create a consolidated legislation concerning this topic.

Regulation of Corporate Groups is not an impossible idea despite the real difficulty of achieving this purpose.[15] In fact, some countries have regulated Corporate Group's incorporation and organization. The practical application of these rules has not been free of problems, and it can always be improved. Obviously, we do not have to follow German or Portuguese regulation, but their experience lights up the way.

[13] In this sense, the Project of the Ninth Directive, and its finally failure in enacting a homogenous and general regulation for Corporate Groups proves the difficulty and challenge of this idea.

[14] Not only in a national perspective. Actually, Private International Law also deals with issues and problems arising from international Corporate Groups in the different areas of Law. PALAO MORENO, Guillermo. *Los grupos de empresas multinacionales y el contrato individual de trabajo*.

[15] EMBID IRUJO, José Miguel, *Introducción al derecho de los grupos de sociedades*, pg 18.

2.1.5. Different interests involved

There are several different interests related to the existence of a Corporate Group either inside the group or outside (*i.e.* interest of third parties related to the group).

Inside the group, there can be a tension between common interest of the group as a whole and the individual interest of each company member. Both these interests are valid and legitimate; thus, they should be protected.

(i) *Dominant Company's shareholders*

When the operational management of the main company is transferred to the subsidiaries of the group, the shareholders of the main company loose the control of their assets.[16] This transfer of control may relevant issues when it affects to the core business of a company. In this case, the main company is changed into a holding and, therefore, its corporate purpose is affected. There is not a current change of purpose, but it becomes an indirect purpose.

As a consequence, the decisions concerning the policy of capitals or the dividends policy[17] may not be under the shareholder's control. This control may go to the Board of Directors of the dominant company, who attends to the Shareholder´s Meeting of the subsidiaries with the majority of the voting rights.

Actually, other situations such as mergers, divisions, partial divisions or transfers of assets are properly regulated and some mechanisms are established in order to protect shareholders and creditors of the companies. Nevertheless, there is a lack of regulation concerning other transformations that result in Corporate Groups which have the same result.

(ii) *Subsidiary's minority shareholders*

The protection of the subsidiary´s minority shareholders results from the breakdown of the subsidiary's management autonomy. Despite they continue being legally autonomous, in fact they are managed by the dominant company. Subsidiary's govern

[16] PAZ-ARES, *Supra 2,* pg. 628. Corporation Group´s structure erodes the power of the Shareholder's Meeting in favor of the Board of Directors.

[17] The Directors may retain the profits in the subsidiaries in order to not being distributed between dominant's shareholders, and they may decide about the collection of funding and investment or loans between the companies.

bodies are devoid of content. Consequently, the interest of the subsidiary is clearly on risk to be subject to the group´s or dominant´s interest.

Dominant´s interest is maximizing the profits of itself or the profits of the group, and minority shareholder's interest is maximizing the profits of the company in which they invested into. Both interests are legitimate. Sometimes, both interests are correlative and simultaneous. Indeed, the group is formed usually to maximize the productivity of the holding, which benefits all the members of the group. Nevertheless, as it has been pointed out above, sometimes, those interests are opposite. In these cases, protection to minority shareholders is necessary. However, the protection should be higher in the case that the dominant´s interest is maximizing its own profits than the event that the objective of the dominant is truly maximize the profits of the group.[18] The reason is that the interest of the group has to be also recognized as a legitimate interest.

(iii) *Creditors*

The patrimonial autonomy of each of the members of the group is also affected by the group policy. It is possible that transfers of assets, capital, activity, clients, or human resources occur into the group. Such transfers may be against the interest of one of the companies of the group. This fact could affect the legitimate right of third parties that have commercial or labor relationships with that company.

2.2. International Overview

As it was mentioned above, most of the countries do not have a specific general regulation for Corporate Groups, despite of there are some exceptions such as Germany and Portugal.[19]

Additionally, two different approaches are followed by theorist regarding this topic: separate legal entity doctrine or legal enterprise doctrine.

2.2.1. Spain

The main issue in the Spanish legal regime regarding Corporate Groups is the lack of a specific regulation. Additionally, the treatment of groups in the Spanish legislation

[18] PAZ-ARES, *Supra 2*, pg. 627.
[19] MCCOURT, *Supra 4*, pg. 7

neither is systematic, nor homogeneous. Moreover, the concept of Corporate Group is fragmented and there is no a clear limitation of what constitutes a group. This fact reveals that there has not been a clear legal policy planning concerning to this topic.[20] For example, on one hand, in the Spanish Commercial Code and in the Spanish Capital Companies Law, the existence of a group is exclusively defined by the existence of a control situation. This control may be acquired by corporate ways or by another ways.

On the other hand, in the Securities Market Law, the main characteristic in order to determine when we are facing a Corporate Group is the existence of a "unit of decision". Obviously, there is a presumption that a unit of decision exists in all control situations. Nevertheless, the hypothesis of a horizontal Corporate Group is also provided.

This dualistic approach to the concept of groups has fomented several studies and works by Spanish theorists.

Additionally, other areas of Law regulate some issues related to Corporate Groups. For instance, Tax Law also defines the group as a corporate situation where one company dominates other/s dependent company/ies.[21] Here again the control is the relevant issue, and the concept of group is limited to the vertical one.

Spanish Labor Courts have also elaborated criteria to decide when a group exists in order to protect worker´s rights. In this sense, all the companies of the group might be responsible for the labor debts of one of them. From the labor perspective, the following circumstances presuppose the existence of a group: confusion of assets into the group, sharing of workers, exercising a unitary decision power, and creating a unitary appearance in the market.

Consequently, there are several theorists that allege for a proper and necessary treatment of the Corporate Groups in Spain. The current economical crisis, which has affected

[20] RUIZ PERIS, Juan Ignacio, *Los grupos en la Ley de sociedades de responsabilidad limitada. Valoración crítica de una regulación fragmentaria.* pg 8

[21] The concept of group for tax purposes is defined in the article 67 of the Spanish Corporate Income Tax Law: *A company is supposed to domain other when it owns at least 75% of the social capital of other company/ies.* In that case, the group shall apply the fiscal consolidation regime.

specially to Spanish economy, has revealed even further the necessity of regulating and giving an homogeneous treatment to Corporate Groups.

In this context, the protection to creditors and minority shareholders of the subsidiaries is only provided by the general rules of Commercial Law. The parent company shall be liable for the subsidiaries' debts, or shall have a duty towards the subsidiaries' shareholders under general terms. For example, in cases of general tortious liability, cases of liability of the subsidiaries' directors in fact, cases of liability of the director by right,[22] cases when the parent company would secure the subsidiary, or general cases of liability for the piercing – veil doctrine.

2.2.2. Portugal

Portugal is one of the countries that have a specific regulation for Corporate Groups. Taking its inspiration from the German model, Portuguese´s regime tried to fill in the gap between the real economy-legal situation and the traditional legal model referred above.[23]

Specifically, this regulation is provided in the Title VI of the Portuguese Commercial Code[24] (hereinafter, "CSC") under the general term of "affiliated companies", which is subdivided into four different categories (*see below*).

It must be pointed out that an affiliated company is a "*strict legal concept*",[25] not a factual one. We talk about an affiliate company only when the concrete case fits in one of the categories fixed by Law. Consequently, the problem of regulatory gaps is not completely solved. Additionally, this concept is only applicable from a commercial perspective, and consequently, other definition of Corporate Group can be found in other areas of Law.

The mentioned four different categories are the following:

(i) *Relationship of simple participation*

[22] Article 367 of Spanish Commercial Code.
[23] VENTURA, Raúl., *Grupos de Sociedades – Uma introdução comparativa a propósito de um Projecto Preliminar de Directiva da CEE*. 305-362.
[24] Availabe at: http://www.cmvm.pt/EN/Legislacao_Regulamentos/Legislacao%20Complementar/Emitentes/Documents/Final2009.Commercial%20Company%20Act.consol8.2007andDL357A.2007.pdf
[25] ANTUNES, José Engrácia, *The Law of Corporate Groups in Portugal*. pg.4.

This type of relationship is regulated in the articles 483 and 484 CSC. It is considered that a company has a relationship with another one when it holds at least 10% of its shares and when between these companies does not exist another type of affiliation relationship (for example, a domination relationship).[26] The last condition leads to unfair situations, such as the case in where two companies with relevant participations between them do not have to comply with the requirements of this typology because their affiliation corresponds to another typology.[27]

In this type of affiliation, a written communication must be done by the tenant of the shares to the other, informing of the acquisition, and any eventual further purchases. Nevertheless, there is no sanction if this duty is not complied, which make this regime inefficient.

(ii) *Relationship of mutual participation*

This type of relationship is established in the article 485 CSC, and it concerns those cases where two companies hold at least 10% of shares reciprocally. This participation can be direct or indirect, and a relationship of domination cannot exist between the companies. In this case, the obligation to communicate also exists for both companies.

The Law forbids the company that communicates the participation later in time to acquire more than 10% of shares of the other company.[28]

In the event that this prohibition were infringe, the new purchase will not be void, but the excess of 10% of shares will not grant voting rights to the purchaser. Additionally, the directors of the acquiring company could be civil and criminal liable.

(iii) *Relationship of domination*

It is regulated under articles 486 and 487 CSC. This type of relationship exists when a company can dominate directly or indirectly another company. This domination is presumed when one company has the majority of the capital, voting rights or the power to nominate the directors or supervisors of another company.[29] In these cases, there is

[26] ANTUNES, *Supra 26*, pg.14-17
[27] TRIGO, María da Graça., *Grupos de Sociedades*, pg 67.
[28] ANTUNES, José Engrácia, *Os Grupos de Sociedades – Estrutura e Organização Jurídica da Empresa Plurissocietária,* pg 340;
[29] ANTUNES, Supra 29, pg 451

only a general duty of disclosure of the relationship in the annual accounts of both companies; and a general prohibition for the dependent company on purchasing dominating company's shares.

Consequently, neither rule concerning the protection of the autonomy of the dependent company, nor concerning the legitimacy of the dominating company to act in interest of the whole group against the particular interest of the subsidiary is provided in the Portuguese regime. This fact leads us to the general corporate rules concerning these issues, with the typical related problems.

(iv) *Relationship of group*

There is not a definition of group of companies, the Law only provides three different ways to create and organize a Corporate Group:

a) The total domination (articles 488 to 491 CSC). This case happens when one company holds the 100% of other company. The total domination can be "initial", based on the creation of a new subsidiary (exclusively decided by the board of directors of the parent company) or "successive" based on the purchase of an existing company (that requires the agreement of the General Meeting of the Board of Directors)[30]. Additionally, the Law provides a special regime that facilitates (and sometimes compels to) the full acquisition of the subsidiary company when the parent already owns at least 90% of subsidiary's shares.[31]

b) The contract of horizontal group (article 492 CSC). The Law does not provide any effect for this type of group. The integrated companies must remain independents and under a unitary direction.

c) Contract of subordination (articles 493 to 508 CSC). This contract must be approved by a qualified majority of both companies, and put the relationship in a special legal framework.[32] Under this contract, the dominating company could direct the management of the subsidiary in a disadvantageous way for its interest, with an adequate compensation. Additionally, the subsidiary's shareholders could leave the company, and have the right to sell their shares to the dominating company, receiving its

[30] FRANÇA, María Augusta, *A estrutura das Sociedades Anónimas em Relação de Grupo*. Pg. 22.
[31] Article 490 CSC: Acquisitions leading to Total Control (Takeovers) provision.
[32] Articles 496 CSC, 498 CSC, 505 CSC and 506 CSC

value in cash or in dominating company's shares. If they decide to continue in the subsidiary, they have the right to receive a guarantee annual dividend.[33]

In order to protect subsidiary's creditors, the parent company shall cover all annual losses of the subsidiary and shall be directly liable for the subsidiary's debts if it does not pay them after being required to do so.

2.2.3. Germany

The German Corporate Groups Regime was the first to provide a specific regulation for the relationships between the companies that form a group. The German Stock Corporation Act of 1965 dealt with this issue as a result of the corporate concentration that was taking place in the first half of the last century.[34]

German Law provides two categories of Corporate Groups, which can operate as a single enterprise, with a special protection of creditors and minority shareholders.

Firstly, the Contract Group, which is regulated by articles 291 to 310,[35] includes the control groups (when a company acquires the power to direct another company, even when it is detrimental for the controlled company but needed for the good of the group as a whole), or profit transfer agreements (when a company undertakes to transfer its entire profits to another enterprise). The agreement must be approved by three quarter's majority of the shareholders of both companies (controller and controlled) in a general meeting.

The contract must be in writing, registered and made available for the shareholders. Additionally, there are some protections for the controlled shareholders: article 304 establishes the duty of paying an annual compensation to them, fixed by reference to the previous and expected profits. By contrast, in the event that the shareholders do not

[33] ANTUNES José Engrácia, *Os direitos dos sócios da sociedade-mãe na formação e direcção dos grupos societários*. Pg 33-39

[34] HAAR, Brigitte, *Corporate Group Law. Encyclopedia of European Private Law*, pg 1. "*Since the formation of cartels was generally allowed in Germany, corporate concentration was spreading and soon after the Second World War the opinion prevailed that regulatory reform was indeed necessary. After the German Corporation Act of 1937 had been limited to regulations and affiliation agreements, only the German Corporation Act of 1965 provided for group-specific, albeit fragmentary regulations*."

[35] German Stock Corporation Act of 1965, in its translation provided by Norton Rose L.L.P., available at: http://www.nortonrosefulbright.com/files/german-stock-corporation-act-2010-english-translation-pdf-59656.pdf

want to maintain the controlled company, the parent company shall compensate them with shares of the controlling company, or with cash payment.

In order to protect creditors, the Law establishes an obligation to cover losses of the controlled companies, without a requirement to prove a causal link between the parent's decisions and subsidiary's loses. Additionally, mandatory reserves must be constituted for the subsidiary.[36]

Secondly, the Facto Group is also recognized under the articles 311 to 318 of the Stock Corporate Act, which try to maintain the independence of the controlled company and protect its shareholders and creditors. In these cases, the controlling company is not allowed to act in detriment of the controlled company, unless it compensates the financial loss in the same financial year. If the parent company fails to compensate, the controlled company can claim for damages. Additionally, the directors of the controlled company must prepare an annual report identifying the transactions and other relations with affiliated companies, and indicate if any compensation is due. Nevertheless, the level of protection in this type of Corporate Group is considered lower than the contract group´s one. There is a practical difficulty to identify each transaction between the companies that provokes loses. Consequently, the parent's liability is difficult to prove.[37]

However, it has to be pointed out that actually, the contract group has been little used. Most groups have chosen the facto group typology. The reason may be the burdens imposed to such groups, and the reluctance of the courts to intervene in the facto groups.[38]

In addition, both regimes are only applicable to public limited liability companies (*Aktiengesellschaft*, AG). Consequently, the most used companies, private limited liability companies (*Gesellschaftmitbeschränk-terHaftung*, GmbH) neither are bound by those protections, nor legitimated when they form a Corporate Group.

In these situations, after different approaches by the German Courts,[39] the case Law established that the provisions for public limited liability companies cannot be applied

[36] Articles 300 to 303 of the German Stock Corporation Act of 1965
[37] MCCOURT, *Supra 4*, pg 11-15
[38] DINE, JANET. *The Governance of Corporate Groups*. pg. 58.
[39] *Autokran Case.; and, by contrast, Bremer-Vulkan Case (17-IX-2001)*

by analogy to the private limited liability companies. Therefore, the subsidiaries' minority shareholders and creditors of the last type of companies are only protected by the general fiduciary duty of the dominant shareholders, the piercing – veil doctrine and the liability of the subsidiaries' directors in fact.

Finally, the German Corporate Groups regime is not the best example to be followed by Europe or those countries that have not a specific regulation for groups. Nevertheless, Germany has the merit to be the first one to regulate this issue, and can be used as a scheme (in its rights and wrongs) to start a new and improved system.[40]

2.2.4. Common Law Countries. US and UK

(i) United Kingdom

UK is the most extreme example of the theory of independent legal personality of each company,[41] based on a strong belief in the economy free enterprise theory, which refuses in principle any other regulation than the essential rules framing the perfect market.

In this context, English Law does not have a special regulation for Corporate Groups. Furthermore, the topic was partially covered by the English Companies Act 1985[42] and now it is covered by the Companies Act 2006.[43] In particular, these Acts establish the criteria to consider a company as a parent company or subsidiary, especially concerning two issues: for accounting purposes and the duty to report the participation held in the subsidiaries by the parent's company. Such criteria are: (i) holding the majority of the voting rights in other company; (ii) having the power to appoint and remove the majority of its directors; (iii) exercising a dominant position by a control agreement or by the Articles (legal control); (iv) having the power to exercise or exercising control over other company or manage it under an unified direction (factual control).[44]

Nevertheless, out of the tax and accounting areas, courts are reluctant to admit the reality of interrelated companies acting as a whole enterprise. The governance of the groups is dealt by the general commercial rules. The most relevant rules that impact on

[40] MCCOURT, *Supra 4,* pg. 11-15
[41] For instance, *Salomon v. Salomon Co. Ltd case* in 1897.
[42] Available at: http://www.legislation.gov.uk/ukpga/1985/6
[43] Available at: http://www.legislation.gov.uk/ukpga/2006/46/introduction
[44] HOPT, Klaus J. *Estudios de Derecho de Sociedades y del Mercado de Valores.* Pg 101-107

groups are those concerning the protection of creditors by mandatory disclosure rules, director´s duties and the oppression of minority shareholders; and the insolvency rules.[45] Additionally, in cases of fraud, courts follow the "piercing the corporate veil" doctrine.[46]

(ii) United States

Due to political and historical reasons,[47] United States has a traditional model of corporate Law based on the separate corporate entity and limited shareholder liability. Nevertheless, from the beginning of 20th Century, when corporations were allowed to own shares in other companies, the economical reality started to change. Of course, Courts established some exemptions to the limited liability of the shareholders, in particular by the doctrine of "piercing the corporate veil", very similar in all common Law countries.[48]

Consequently, enterprise theory[49] was adopted by some rules and areas in US during the second half of the 20th Century. In particular, the Regime for Securities regulates all the companies that are under the control of the regulated corporation. The purpose is obviously to protect the investors, but also to make the securities market safer.

Labor Law has also adopted the enterprise analysis to protect the employees and labor union rights. In this sense, all affiliated companies are seen as a unique employer. Companies will be considered to be affiliated if: (i) an interrelationship of operations exists between the companies; (ii) the companies exercise a centralized labor politic; (iii) a common direction exists; and (iv) the companies are owned and managed by the same shareholders.

[45] Insolvency Act of 1986. Available at: http://www.legislation.gov.uk/ukpga/1986/45/contents. Article 214 extends liability of wrongful trading to the "shadow director", which can be a parent company if it usually instructs to subsidiary's board of director. This Article enables the Courts to order the director to make a "proper contribution to the company's assets".
[46] BICKER, Eike Thomas, *Creditor protection in the Corporate Group.* pg 5
[47] Entity Law approach was motivated by the rights granted to corporations by the U.S. Constitution.
[48] MATHESON, John H. *The Modern Law of Corporate Groups: An empirical study of piercing the corporate veil in the parent – subsidiary context*. pg. 1098-1104
[49] The enterprise approach focuses on the actual operating business, not in the legal formal personality. In this sense, if the companies are economically integrated and under the same effective direction, they are seen as a unique enterprise.

Additionally, Tax Law (to prevent tax abuses) and Jurisdiction Procedure Law[50] also have some rules that deal with Corporate Groups as an only enterprise. These examples show how the enterprise doctrine has its place in the US jurisdiction, although the initial domination of the separate legal entity doctrine. Nevertheless, as happens in other countries, the fragmentary regulation, the different legal approaches that coexist in the economic reality and the lack of proper regulation about corporate Law, leave the matter in hands of courts.

2.2.5. European Union

The European Union also presents the issue of lack of regulation for Corporate Groups. The conscience of the necessity of regulating this phenomenon has been evident along last years, but without a clear success.

More than 30 years ago, two Directives were drafted concerning Corporate Groups: one was concerning accounting aspects and another was concerning legal-substantive aspects. The first was finally enacted, and it was adopted by the different Member States.[51]

However, the second one, called the 9th Directive of 1984 was never approved. This 9th Directive followed the German model, and tried to harmonize the regulation of Corporate Groups. It ended up in a failure.

Additionally, the Law of the Societas Europaea (SE) of 2004[52] was also insufficient: unless it mentioned some aspects related to Corporate Groups (such as the cross border affiliations, international holdings, or transferring assets), it did not include provisions establishing a proper regime for this figure.

Therefore, the Phenomenon of the Corporate Groups in Europe was necessarily analyzed by the European Case Law of the ECJ. In particular, it was analyzed in the rulings concerning fundamental freedoms,[53] as well as in the rulings concerning

[50] STRASSER, *Supra 1*, pg 18.
[51] For example, in Spain, the mentioned article 42 of the Commercial Code was inspirited in the Directive 83/349/CEE, of 13 June 1983, concerning consolidated accounts.
[52] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE).
[53] For example, ECJ Case C-221/97 *Centros Ltd v. Erhvervs- ogSelskabsstyrelsen* [1999] ECR I-1459

taxation of corporate Law.[54] In these rulings, the idea of harmonizing the corporate Law of the different Member States has been superseded by the statement of requirements to operate in a European Level (also regarding Corporate Groups).

In addition to the failure to harmonize the general Corporate Group's regime, the rest of regulations enacted were fragmentary, concerning different aspects related to this issue. For instance, accounting and auditing Law has developed several rules to European Corporate Groups (7th Directive, 83/349; and the IAS-Regulation). There have been also enacted specific Directivesfor some special sectors, such as banks, insurance companies, or financial services companies.[55]

The European Union has given up to the regulation of this issue as a whole, and the power to establish Corporate Group's regime has been transferred to the Member States, under the subsidiary principle. This is the main idea of the Winter Report, (November 2002),[56] a report drafted by a group of legal experts, which sets out the guidelines of the regulation of the companies in the European Union. In this report, Corporate Groups are one of the main issues (jointly with the corporate governance). The Winter Report follows in some terms the proposals made by another group of experts (from private sources), the Forum Europaeum.[57] The Forum focused mainly on the conflicts of interest and it did not use the German model as a standard.

3. THE CORPORATE GOVERNANCE OF GROUPS

3.1. General Considerations

3.1.1. Concept of Corporate Governance

The term of Corporate Governance arose in the United States in the 20th Century, referred to the relationship between the Executive Directors of a public company and its

[54] For example,ECJ, case C-446/03, *Marks & Spencer v. David Halsey* [2005] ECR I-10837
[55] Banking Law Directive of 20 March 2000 (Dir 2000/12); Dir 98/78, Solvency II; Financial Conglomerates Directive of 2002 (Dir 2002/87).
[56] Available at: http://www.ecgi.org/publications/documents/report_en.pdf
[57] Available at: http://www.europaeum.org/europaeum/?q=node/1325

shareholders and Board of Directors.[58] Since that moment, lots of definitions, doctrine and comments have been written over the world concerning this topic.

There is not a unique definition of Corporate Governance. In this sense, the viewpoint of corporate governance depends upon which issues are being observed. Nevertheless, in general corporate governance usually covers the following topics:[59] (i) The protection of shareholder´s rights, providing an effective system to redress and compensate them in the event of any damage to them; (ii) Ensuring the equitable treatment of all the shareholders, in particular minority shareholders; (iii) The protection of stakeholders' rights; (iv) Duties, functions and liability of the Directors of the company, based on ethical behavior, diligence and loyalty; and (v) disclosure of relevant information and transparency.

Those principles are applied in order to protect and promote the interest of the company. However, this interest is not always clear, in particular in Corporate Groups (*see below*). Under some circumstances, the purpose could be the maximization of the dividends for shareholders, but in theory, such interest should aim to the viability of the company in long term, as a social job-creating structure, related to its stakeholders and the environment (corporate social work).

From a legal perspective, Corporate Governance is composed by Corporate, Capital Market and Labor rules concerning the distribution and control of powers between the governing bodies and their liability,[60] in particular for listed companies. Nevertheless, Corporate Governance is also recommendable for companies not listed on regulated markets.

Regarding Corporate Governance of Corporate Groups in particular, it has not been properly analyzed as an independent issue.[61] We only can find some references to Corporate Groups in some of the Corporate Governance rules, for example in the Winter Report, the Principles of OCDE or the Spanish Aldama Report. These references are primarily focus on the disclosure and transparency of the structure of the group, and the

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[58] HAMILTON, Robert, W. "*Corporate Governance in America 1950-2000: Major Changes but Uncertain Benefits*". pg 349.

[59] Following the principles of the OECD (2004), available at: http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf

[60] CIOFFI, John W. "*State of the Art: A Review Essay on Comparative Corporate Governance: The State of the Art and Emerging Research*", pg 50.

[61] EMBID IRUJO, José Miguel, *El buen gobierno corporativo y los grupos de sociedades.* pg 1-3

balance of the interest involved.[62] Additionally, the liability of the parent company and its directors for the debts and acts of their subsidiaries must be analyzed under the corporate governance perspective as a mechanism to ensure the effective protection of the shareholders and stakeholders of the Corporate Group.

Additionally, due to the deregulation trends in the 20th Century, the compulsory rules concerning corporate Law was substituted by soft Law and recommendations made by legal experts. This soft Law is based on the principle "comply or explain".

3.1.2. Formation of the group

Just here a brief note to point out the relevance of the way chosen to form a Corporate Group in the future corporate governance of its member companies. As it was previously referred concerning the dominant's shareholders interest (*section 2.1.5*), the formation of a group tends to limit the power of the parent's shareholders and subsidiaries, and tends to transfer this power to the parent's Board of Directors.

This danger is especially relevant in the facto groups, where no formal agreement is made between the companies and the distribution of competences and organization of the group is not provided by any statute.The shareholders of the parent company are usually outside the sphere of decision-making to form a group because the way to make such formation does not need their later legitimating approval.The powers to purchase shares of other company, or to create a new company is usually exclusively in hands of the Board of Directors.

By contrast, in the case of legal groups, it is usual the requirement of the participation of the parent´s shareholder, at least in the conclusion of the agreement or in its registration.[63] This intervention does not guarantee the full future protection of their interest in the new formed group, but the conditions of the organization and governance of the group can be negotiated.

3.1.3. The Group decision making

- **Disclosure and transparency of the structure of governing bodies.**

[62] In addition to general interests involved in corporate governance, in the case of Corporate Groups the tension between parent and subsidiaries' interests must be also taken into account.
[63] For instance, Article 496 of Portuguese Commercial Company Act.

The structure of the government of the Corporate Groups will depend on the general system of corporate management. For instance, the German model is based on a two-tier system, with a Board of Directors (Vorstand) and a Supervisory Board (Aufsichtsrat).[64] In this system, the Supervisory Board has the power to appoint and revoke the Directors.

By contrast, the Spanish model or the English model is based on a single-tier system, where the Management can be done by a sole director, several directors or by a collegiate body, but without a supervisory body. Other countries, such as France or Italy, allow the shareholders to choose between the two types of systems. Logically, the structure to make decisions in one and the other typology will be different.

In any case, the control of the group will be in hands of the parent´s board of director.[65] The Meeting of Shareholders maintains its power appointing and removing Directors, ratifying or revoking appointments. This power can be exercise directly (in the case of the single-tier system) or indirectly in the case of the two-tier system (appointing the members of the Supervisory Body). Consequently, the Directors usually would manage the company according to the interests of the majority of shareholders.

Additionally, under the General Corporate Law of all the countries, the General Meeting of Shareholders maintains some management powers, especially concerning the structural modifications of the company.[66] In some countries, such as Spain or Italy, the General Meeting of Shareholders can increase their competences, always respecting the mandatory powers of the Board of Directors. By contrast, in Germany the powers of the Shareholders cannot be amplified by the Articles of the Company.

Therefore, within the governing bodies of the Corporate Group exists a balance that will be more or less tipped towards the majority shareholders or the Board of Directors, depending of particular circumstances.

In any case, in order to protect the different interests of all the shareholders, as such as the stakeholders, the relevant point concerning the corporate governance in both systems is the transparency and disclosure of the government structure.

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[64] Article 30 and following of the German Stock Corporation Act
[65] ANTUNES, *Supra 34,* pg. 155
[66] In particular, the modification of the Articles of the company, the increase or reduction of the share capital, mergers, dissolution or liquidation of the company.

In general, the disclosure provisions and transparency requirements usually refer to the listed companies. Nevertheless, these aims are desirable for all the companies, not only the listed ones. The group involveS too many interested parties that deserve the protection of a proper corporate governance of the Corporate Group.

In the light of the recommendations of the OECD,[67] the following information must be provided to any interested party: (i) the financial statements and annual operating results of the company. In the case of Corporate Groups, the consolidated accounts should provide a detailed explication concerning the solvency of every member company and the group as a whole; (ii) the company objectives; (iii) the majority share ownerships and their voting rights; (iv) the members of the Board of Directors, their formation and remuneration; (v) the related transactions, which is very relevant in the case of Corporate Groups; (vi) foreseeable risks, in the case of Corporate Groups, these risks shall concern every company member and the group as a whole; (vii) issues concerning employees or other stakeholders,which could affect the managing of the Corporate Group or its solvency; and (viii) any corporate governance code or policy adopted.

As it can be observed, the disclosure of the structure of the governing bodies occupies a relevant issue in order to assess that a company is transparent. This information becomes even more important in the case of Corporate Groups, where the powers can be distributed and exercise more stealthily.

Additionally, any control agreement, shareholder agreements, the relationships between the different companies that form part of the Corporate Group and the relationships between the different directors of the member companies should be disclose.[68]

This information should be provided to all of the shareholders and investors of the Corporate Group, and should be included in the annual report of the company.

- **Corporate Group Purpose. Different interests involved**

The plurality of interests in the Corporate Groups, and the eventual conflicts between those interests are ones of the most relevant matters concerning this topic. Apart from the referred duty of the directors and companies to disclose their conflict of interests,

[67] Available at: http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdfpg 49.
[68] EMBID IRUJO, *Supra 62*. pg 7

another issue must be analyzed in order to establish the rights, duties and liability of the parent companies and the directors: the legitimacy of the Corporate Group´s interest, and its prevalence over the subsidiaries' interests.

This issue raises the question of which interest must be considered as the corporate purpose of each member of the group. May the interest of a company be a different interest from its shareholder´s interest? Actually, the existence of a common and superior interest for the Corporate Group is recognized in some countries.[69] Nevertheless, this question, its limits and legitimacy must be clarified in order to establish a proper corporate governance regime for Corporate Groups.

The conflicts of interest's resolution should be established in the corporate governance guidance of the group. The directors need to know what interest they must be loyal to, and shareholders need to know what they can expect and require from the directors. In any case, Directors could never act against the Law or the subsidiaries' articles.[70]

Additionally, the interest cannot be seen only as the maximization of the profits of the shareholders. Other aspects must be taken into account, such as the long-term viability and the social purpose of the company.[71] This approach has been verified by the recent scandals known during the financial crisis, which have reflected the necessity to respect also the stakeholder´s interests and focus the group towards the principles of Corporate Social Responsibility.[72]

3.1.4. Rights and duties of the parent company

When the Corporate Group is formed, the parent company increases its size, its structure; and this formation can involve new rights and duties already mentioned, such as the disclosure duty and consolidated accounts. Additionally, it may increase its risk

[69] For instance, under German Regime and Portuguese Regime

[70] In this sense, for instance, Article 223 of Spanish Capital Companies Law, which establishes the duty of loyalty of the Directors of the company

[71] PÉREZ CARRILLO, Elena F. *Gobierno corporativo en la unión europea. Evolución conceptual y de método.*Pg. 8-9. The author refers to the ALI (American Law Institute) Principles, which establishes that jointly with the maximization of the profits, the company must comply with its ethic duties.

[72] Concept of Corporate Social Responsibility based on the Green Paper (2001) - Promoting a European framework for Corporate Social Responsibility

sphere, in particular in those regimes where the Law establishes the liability of the parent company for subsidiaries' debts.[73]

In other cases, when there is not a mandatory liability of the parent company for the acts of its subsidiaries, such liability can be determined by the jurisprudence, based on the management in fact done by the parent company, or by the doctrine of corporate veil.

In either case, these facts point out the need of the development of a corporate governance regime regarding the governance of Corporate Groups. The correct management of a company is essential in order to protect the interests of all shareholders and stakeholders.

- **Parent company as a de facto manager**

The de facto manager is the manager that effectively carries out the management of a company, without a formal nomination. This concept is a figure set out in all the legal regimes[74.]

The acts detrimental to the company made by managers in fact are not void, although they were not formally empowered to administer the company. The detrimental act continues to be valid and effective. Nevertheless, the managers in fact shall be liable for the consequences of their management in the same way of a manager in right. The liability of the managers in right comes from the European Law,[75] and it is justified by the legal safeguard for commercial transactions. This legal safeguard cannot be broken by the existence of managers in fact, who are not published in the Commercial Registry and may be unknown for the stakeholders.

The ideas referred concerning the managers in fact shall be applied to the case of Corporate Groups and related undertakings. A company can be considered as the manager in fact of a related company. In this sense, the criteria are the actual performance of the governance bodies, its accordance with the legal provisions

[73] For example, German and Portuguese regime.
[74] For instance, in the Art. 236 of the Spanish Capital Companies Law, or Section 741 of the English Companies Act 1985
[75] Article 9 of the Directive 68/151/CEE, available at:http://portaljuridico.lexnova.es/legislacion/JURIDICO/82695/primera-directiva-68-151-cee-del-consejo-de-9-de-marzo-de-1968-tendente-a-coordinar-para-hacerlas#A0009_00

established by Law and Corporate Articles, and the level of integration of the companies.

The management in fact is clearer in the case of vertical groups than in the case of horizontal case. Nevertheless, we must focus on the existence of a unit of decision, and if this unit of decision is exercised in a way that encroaches upon the powers of the dominated companies' governance bodies, appearing in this way the dominant as the effective manager of the dominated companies.

Nevertheless, the organizational nature of the decisions must be always analyzed. Even in the vertical groups, if a decision is done by the formal managers of a subsidiary under its autonomy power, the parent company will never be liable. If such decision is made following the instructions of the parent company, a distinction must be done: (i) if the decision is made following the organizational structure, that is, by the intervention of the parent´s shareholders in the subsidiary's General Meeting, the manager in fact will be the parent company; (ii) if the decision is made by the parent´s managers without respecting the formal procedures, they will be the managers in fact of the subsidiary.

Finally, to conclude, who acts as the manager of a company, independently of complying or not with the legal formalities, always has to comply with the duties and diligence due by the manager in right. These duties will lead to the eventual liability for the management that was effectively carried out.

3.1.5. Duties and liability of directors.

One of the principal purposes of corporate governance framework is the establishment of a successful duties and liability system for the directors. As stated above, the parent company of a Corporate Group or its directors, as the directors in fact of the subsidiaries, shall also comply with these duties, adapted to the special requirements of a Corporate Group.

The general duties demanded to the directors are focus on the diligence and loyalty.[76] In particular, a "diligent management" means acting as a prudent business person and be diligently up to date about the administration of the company. Additionally, certain qualification could be required or a minimum of time of dedication could be also

[76] ALFONSO SÁNCHEZ, Rosalía, Mercedes, SÁNCHEZ RUIZ, *Aspectos generales sobre el buen gobierno de las cooperativas y de los grupos cooperativos.* pg. 1069

required.[77] In this point is relevant to point out that a diligent manager should always act according to the Law and the Statutes of the Company.

Diligence is linked to the other duty of the directors: loyalty. It is clear and undisputed that the director must act according to Law and Statutes, in the best interest of the company. In this point, the issue of what interest the director of a Corporate Group must protect appears again when the diligence of such director is analyzed.

It has been deeply analyzed the loyalty duties of directors regarding the prohibition to take personal advantages of business opportunities, prohibition to use the company´s name to carry out personal interests, prohibition to compete, the duty to disclose conflicts of interests and duty of secrecy.[78] In Corporate Groups, the main issue is not only the eventual personal benefit of the director. In Corporate Group the illegitimate benefit of a company taken from its subsidiaries may also be considered as a failure to comply with loyalty and diligence duty.

When such benefit of the parent company must be considered illegitimate, and therefore, against to the duties of the directors of the subsidiary is not clearly established. This lack of regulation produces legal uncertainty in the way that it is not clear when the director can be considered liable for the damages caused by his acts.

- **Liability of the parent company for the subsidiary's acts and debts**

The previous assessments, concerning the parent company as a manager in fact, and the duties and liability of the managers of the company, lead to the logical issue of considering the parent company liable for the acts and debts of the subsidiaries.

This analysis has to be made both in regimes without Corporate Group's regime (Spanish or English regime) and in regimes with a Group's regulation (German and Portuguese regime). As it was exposed in the second section of this work, even in the cases of Portugal and Germany, due to the weaknesses of its regimes, Courts have to apply the doctrine of piercing the corporate veil and abuse of legal personality several times in order to make parent company liable for the acts of its subsidiaries.[79]

[77] Walker Report, Recommendation 1, 3, 5, 7
[78] As it is reflected in PÉREZ CARRILLO, Elena F. *Gobierno corporativo en la unión europea. Evolución conceptual y de método.*
[79] *Bremer Vulkan Case,* judgment of the German Supreme Court from 19.9.2001 -, NJW 2001, 3577-3581

Additionally, Courts can apply to the extra contractual liability of the parent companies and the liability of the administrators in fact.

Nevertheless, the liability of the parent company cannot be a general rule.[80] A justification must exist in order to justify such liability, and an eventual punishment. Only in those cases where the parent company acts as an effective manager in fact, shall be bounded by the manager´s duties. In those cases, the parent company will be also liable if it does not comply with such duties.

The consequences of these assessments are double: (i) the shareholders of the subsidiary have the chance to demand accountability for the damages caused to the subsidiary or to them; and (ii) the stakeholders of the subsidiaries may also demand for compensation if they are harmed by the parent company´s acts as manager of the subsidiary. However, the liability of the parent company shall not exclude the liability of the subsidiary. The managers by right of the subsidiary must also comply with their legal duties.[81] In this way, the jointly shared liability shall be applied.

3.2. International Overview

During the last century, corporate governance has been discussed and developed in all countries.[82] In a general analysis, we can classify the corporate governance regimes into two groups: the American Corporate Governance and the European Corporate Governance.[83] Some similarities and differences can be found between the development of each group and in the development of each country corporate governance regime.[84]

3.2.1. Corporate Governance in United States

[80] GARCÍA-CRUCES, José Antonio, *Insolvencia de la filial y responsabilidad de la sociedad dominante como "administrador de hecho".* Pg.11

[81] For instance, the Spanish Supreme Court decision of October, 28 of 2002 (RJ/2002/9145) establishes that: "It is not accepted the argument that the appellant was only administrator nominal and remained almost outside the management of the company, because the Article 127-1 of the Spanish Companies Act requires directors hold office with the diligence of a prudent businessman and legal representative"

[82] For instance, the Cromme Commission Code (Germany, 2001), Securities Market Commission Recommendations (Portugal, 1999), Codigo Conthe (Spain); Sarbanes-Oxley Act (USA, 2002); Asset Manager Code of Professional Conduct (USA, 2004); AUTIF Code (UK, 2001); and in International Organizations: OECD Principles of Corporate Governance (1999); EASD Principles and Recommendations (2000).

[83] BLANCO DOPICO, María Isabel, El buen gobierno corporativo y los requerimentos informativos sobre los sistemas de control interno y riesgos: análisis de la regulación española y portuguesa en relación a otros referentes. Revista de EstudiosPolitécnicos, Vol VII, nº 12, 075-097 (2009)

[84] Following the Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States, WEIL, Gothshal&Manges, (2001).

On one hand, the Anglo-Saxon countries created the idea of corporate governance and it turned into a reference for the rest of countries. The first concept of corporate governance was based on the mentioned principle of "comply or explain". Nevertheless, the regime became stricter over the time, with the purpose to protect the investors and the society at large.

In United States, the duty to disclose information regarding the financial transactions of the companies came to be compulsory.[85] This change was due to some financial scandals, such as Enron or WorldCom. In this sense, Sarbanes-Oxley Act of 2002 (SOX)[86] was enacted. This Act was the starting point of the compulsory disclosure concerning the corporate responsibility, relationships of the company with external auditors, financial information and intern control. The Act also established the punishments for the administrators that do not comply with such duties.

Nevertheless, this new approach to the Corporate Governance received some critics: the high costs of the implementation of the control systems, the unfair global competition of other countries more permissive, the actual political reasons that motivated the enactment of the Law and the compliance cost for medium and small companies.

Recently, the Obama Administration enacted the Dodd-Frank Act in 2010,[87] that followed the SOX criteria, and the New York Stock Exchange published the Report of the New York Stock Exchange Commission on Corporate Governance on September 23th of 2010.[88] This report reviewed the principles of corporate governance under the light of the recent events. The principles concerning the structure and the role of the Board of Directors established the necessity of taking into account the specific circumstances of each company. In this sense, this issue is not susceptible to be ruled by mandatory regulations. Each company has to analyze its own situation, and determine the best corporate governance in order to "build long-term sustainable growth in

[85] BAKER, Charles, *Ideological reactions to Sarbanes-Oxley*. Accounting Forum, 32(2), pg. 116 (2008)
[86] Sarbanes-Oxley Act of 2002, L. Nº 107-204, 116 Stat. 745, of July 30th of 2002. This Act was a milestone, since it mainstreamed into federal rules issues concerning corporate governance. Until that moment, such issues was only dealt by state rules.
[87] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, H.R. 4173, of July 21th of 2010. This Act involves a far-reaching social and political reform motivated by the financial crisis initiated by the bankruptcy of Lehman Brothers.
[88] Available at: http://www.nyse.com/pdfs/CCGReport.pdf

shareholder value for the corporation".[89] Additionally, it establishes that the board is accountable to shareholders for its performance in achieving such objective. In any case, the full disclosure of the structure of the board and the reasons of this structure is due by the companies, in the sense that was referred above.

Nevertheless, specific rules or principles are not established for the corporate governance of Corporate Groups in United States. In this way, the general rules and recommendations are applicable to Corporate Groups, with the consequently lack of proper regulation for some specific issues mentioned above that affects to Corporate Groups. This fact is linked to the referred entity Law approach, followed by the Anglo-Saxon countries. The rules and the principles are created under this approach, without taking into account the Corporate Groups. Later, some mechanisms are established to adjust the Law to the reality. The most important example is the doctrine of "piercing" or "lifting the veil". This doctrine is used to deal with and establish the liability in exceptional cases, when the subsidiaries carry on the parent´s interests and not its own. These cases are individually analyzed and resolved, and this fact gives rise to a degree of legal insecurity.

3.2.2. The European Corporate Governance

Talking about a unique European Corporate Governance model is not easy because the corporate regimes of the Member States are different regarding issues such as the corporate structure. In this sense, as it was referred above, we can find in Europe both the monist and dualistic model of management. There are also different concepts of commercial enterprise, and the interest that should prevail.[90] The European harmonization process has not reached some essential elements of the Corporate Governance, such as the obligations and liability of the directors or the exclusion of the shareholders.

At the end of the 20th Century, the European Company Law was affected by the deregulation tendency. In this sense, different soft Law proposals and recommendations

[89] Principle A of the Report of the New York Stock Exchange Commission on Corporate Governance.Pg. 26.

[90] SÁNCHEZ-CALERO, Francisco Javier, *El interés social y los varios intereses presentes en la sociedad anónima cotizada*, Revista de Derecho Mercantil, núm. 246, pg. 1665 (2002)

were made. These recommendations highlighted the importance of the maximization of the shareholders' value, but with a social perspective. The social mission of the companies began to be taken into account. In this sense, the United Kingdom, traditionally very close to American approach, enacted the Cadbury Report[91] in 1992, that was focused on the defense of the shareholder´s value. However, Hampel Report[92] was enacted in 1998, which introduced the idea of corporate social liability in a long term. This idea was also reflected in the Spanish Olivencia Report.[93] The scandals occurred in Europe at the beginning of the 21th Century confirmed the necessity of taking into account the medium and large term viability of the company, and the interest of the stakeholders, in the same way that happened in United States.

During the nineties Corporate Governance Codes were created in each country. The European Commission assessed if these different codes could affect the Internal Market, and in this way, commissioned a study to analyze the necessity to harmonize such Codes in Europe: the mentioned Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States elaborated by Weil, Gothshal&Manges in 2001. The results of this study gave rise to the conclusion that lot of similarities and some differences exist between the Member State´s Codes, but in general, it is not necessary to harmonize these texts. The main similarities are the independency and leadership of the Audit Committee and the Advisory Committee. The differences are motivated for the differences in the regulation of each country concerning company regime

Simultaneously, there was a concern about the necessity to achieve a legislative development of the European Company regime. After a failed attempt at approving the Takeover Directive in 1999, the Winter Report[94] was created and later extended with the Winter Report II. This Report dealt with the Corporate Groups and the Corporate Governance, though in separate chapters.

[91] Available at: http://www.ecgi.org/codes/documents/cadbury.pdf
[92] Available at: http://www.ecgi.org/codes/documents/hampel_index.htm
[93] Available at: http://www.cnmv.es/DocPortal/Publicaciones/CodigoGov/govsocot.pdf
[94] Report of the high level group of Company Law experts on a modern regulatory framework for Company Law in Europe. Brussels, 4 November 2002 Available at: http://www.ecgi.org/publications/documents/report_en.pdf

Regarding Corporate Governance, the Winter Report recommended some measures, concerning the internal structure of the company, the market context and the protection of stakeholders, which later were introduced by Member States. These measures referred not only to internal structure of the company, but also to the market context and the protection of the stakeholders. In this way, it established that the Member States should develop the corporate governance codes, which the companies must follow or explain the reasons of not following such code.

Between other measures, the Winter Report suggested: the duty to elaborate an Annual Corporate Governance Report by each company, informing about the control structure, the governing bodies structure, conflicts of interests and the rules concerning the corporate governance applied in the company; facilitating the attendance and participation in the General Meeting of Shareholders; the free off choice of each country between the dualistic or monistic model of governance; some recommendations concerning the director´s compensation; and the liability of all the directors for the information provided to the market.

The Winter Report analyzed the Corporate Groups issues in another chapter, but some of them were related to corporate governance. In particular, it proposed some measures to increase the transparency concerning the structure of the group and the relationships between its members. The parent company should be the responsible for providing that information in a correct and truthful way. The Report also defended that the directors of a group could adopt a group policy that favors the group´s interest, even if it is against the particular interests of a subsidiary. However, mechanisms to protect stakeholders and to balance the rights of the different shareholders must be adopted.

In 2003, the European Commission published the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union,[95] where deals with issues posed by the Winter Report. Additionally, exposed the convenience to create European Corporate Governance guidelines to take advantages of the Internal Market and improve the competitiveness of the European companies. Some of the objectives of this Plan were to provide an effective and homogeneous protection for shareholders and stakeholders in all the European Union, to increase the transparency,

[95] Available at: http://ec.europa.eu/internal_market/company/modern/index_en.htm#actionplan2012

and also, to encourage the establishment of a shared liability system for all the members of the Board of directors for "wrongful trading".

In the Action Plan there was also established the creation of the European Corporate Governance Forum,[96] which has made a significant contribution to the development of the corporate governance in Europe during the last years. This impetus to the CorporateGovernance was completed by the Green Papers on Corporate Governance published by European Commission, in 2010 and 2011.[97]

Recently, due to the current economic and financial crisis, the Commission published a new Project to elaborate a new Action Plan to modernise the European Company Law and corporate governance in 2012. This new Action Plan would have the following key points: (i) improve the transparency between companies and their shareholders regarding risk management policies, governing bodies' structure and corporate governance policy; (ii) promote and facilitate long-term shareholder dedication to the company, in order to take power away the board of directors; and (iii) improve the framework for the cross-border operations.

Compared to the American model for corporate governance, the European Corporate Governance Codes continue to be based on the general "comply or explain" model. This fact differs from the SOX in particularly, concerning the structure of the governing bodies, typology of directors, etc. SOX is focused on the compulsory disclosure of this information, while the European tendency is recommend the way that governance should be done. Nevertheless, the convergence of the requirements in both systems is very relevant. The majority of the requirements laid down in the SOX are also contemplated in the European recommendations. It is relevant here to point out the role of the mentioned Organisation for Economic Co-operation and Development (OECD) in this uniformity. Its principles establish the general guidelines that are followed by all the countries. Consequently, it can be assessed that the corporate governance is moving

[96] The reports of this organism are available at: http://ec.europa.eu/internal_market/company/ecgforum/index_en.htm#reports

[97] Avaiable at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0284:FIN:ES:PDF and http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf#page=2

relatively in a convergent direction. Nevertheless, the Corporate Groups issue is not properly taken up as a relevant and independent issue.

4. THE DEFINITION OF THE PROBLEM

4.1. Bringing the two mentioned issues (lack of group's regulation and corporate governance of the groups)

As it was exposed above, Corporate Groups dominate the current economic landscape. Most major businesses in the world are operated through Corporate Groups, not through individual companies.

Faced with this reality, the Law recognizes the separate personality of each member of the group, but in the majority of the countries, the Law ignores the group structure within such companies operate. Even in those countries with a specific regulation for Corporate Groups, such as Portugal or Germany, there are some gaps in the regime. This gap between Law and reality leads to a complex set of problems and tensions both within and outside Corporate Groups.[98]

First of all, several concepts and nature definitions exist even inside the local regimes. This lack of uniformity in the concept reaches its maximum in the global context. An international Corporate Group may be treated as a group in one country, and not as a group in another. These differences occur also inside the European Union. The lack of a proper legislation may produce legal uncertainty, and may facilitate abuses in the markets.

Due to the economical crisis of the recent years, insolvency is one of the areas of Law where such gap has been more noticeable. Additionally, corporate governance failures have also been analyzed exhaustively as one of the causes of such crisis.[99] In consequence, a relation between the Corporate Groups' gap and the failures of corporate governance of the companies that operate in the market may be done. This relationship is confirmed by the Winter Report, which deals with both issues under the same text and the same spirit.

[98] GILLOOLY Michael, *The Law Relating to Corporate Groups,* pg xix.
[99] SÁNCHEZ-CALERO, Francisco Javier, *Crisis Económica y Gobierno Corporativo,* pg 3-4

There is a gap of proper regulation for Corporate Groups that provides a correct framework to establish also a proper corporate governance regime for these groups. This gap is noticeable not only in each country, but also in a European and global level.

To sum up, the two principal problems concerning the corporate governance of Corporate Groups are the following: (i) the transparency of the structure of the group and its relationships; and (ii) the conflict of interests between the members of the group. These issues deal indirectly with the protection of the stakeholders. It may have a direct effect on the creditors and minority shareholders. In this way, their protection might also be granted and improved by the establishment of a proper corporate governance regime for Corporate Groups.

4.2. Transparency of the structure of the group

The disclosure of some kind of information, such as the group structure, governing bodies' structure or the relationships between the members of the board of directors of the group members is one of the main points to be taken into account when corporate governance of groups is analyzed. If disclosure of information is a relevant issue in all companies in order to protect minority shareholders, stakeholders and the market, in the case of Corporate Groups this disclosure is even more important. As recent scandals have revealed during the current financial and economic crisis, the opacity of this data might trigger a negative chain reaction in both national and global economy.

Additionally, the disclosure of information related to transfers of capital, activity, assets or even human resources into the group is advisable in order to protect creditors and other stakeholders. However Corporate Groups are not created in order to commit abuses, the truth is that sometimes the internal transfers of capital may be the way to avoid responsibility towards the creditors.

4.3. Conflict of interests

The referred conflict of interests that occur inside the groups makes the establishment of a corporate governance regime for these enterprises even more difficult. In this case, there are more interests at stake than in case of individual companies. The protection of minority shareholders and third parties that is pursued by corporate governance regime has to be extended to all the subjects involved in the group. For instance, the protection

of minority shareholders has to be extended to all the minority shareholders of all the subsidiaries, because the risk to illegitimately undermine their interests is higher within a Corporate Group structure. This fact makes more difficult, but also more necessary and relevant, a proper corporate governance regime for groups of companies.

The difficulty of establishing the interest of the Corporate Group that has to be protected (an interest for the whole group, or an interest for each member of the group); and the failure to establish a clear rule to deal with eventual conflicts between these different interests may complicated the establishment of a corporate governance regime and a proper duties and right´s regime for the directors of the Corporate Groups. Consequently, the hypothesis of these directors being held accountable for the group´s acts and debts is left up to the case-by-case analysis.

4.4. Failure of auto-regulation?

Regarding the corporate governance, auto-regulation and soft Law has been the tendency to settle this topic, under the belief that this way of legislation would encourage the commitment of the companies to follow the governance guides. In the European Union, soft Law has also been the way to try to coordinate the different regimes of the member states, because soft Law is supposed to facilitate the use of these regimes.[100]

Auto-regulation is the possibility of the economic operators to adopt the general guides suggested by the authorities in this matter. These recommendations are called "soft Law", since they are not compulsory. Nevertheless, as it was exposed above, some of these recommendations have ended up having legal effectiveness, since the non-compliance of some rules might be punished.[101]

This model of regulation was created in Anglo-Saxon countries.[102] The expansion to countries of Roman legal tradition was due to the weaknesses of their system to deal with some problems, such as inappropriate governing bodies' structure, or the abuses in

[100] Communication from the Commission to the Council and the European Parliament: Better Regulation for Growth and Jobs in the European Union {SEC(2005) 175}. Brussels, 16.3.2005. Available at: http://www.eu2005.lu/en/actualites/documents_travail/2005/04/18bettereglet/com2005_0097en01.pdf
[101] For instance, disclosure recommendations were finally introduced in compulsory rules (SOX).
[102] CIOFFI, *Supra 61*, pg 10-11

the remuneration of the directors. These issues are more severe in the case of Corporate Groups. Against this situation, the soft Law created some ethical and voluntary guides.

The legitimacy and guarantee of the compliance of these codes is based on the procedure to create them. The codes or guides are written by experts, professionals and commissions established ad hoc to this purpose. It usually has also an image of neutrality and consensus, because the text is submitted to public consultation. The result is a text that is offered to the company to be voluntary undertaken. Before these codes, the companies must comply or explain.

- **Current failures**

Soft Law was conceived under the idea that the company was the first interested in complying with the recommendations, because this compliance would create a good reputation in the market. That is, the market would judge if the acts of the companies were or not according to the corporate governance codes. This utopian idea has been refused by the reality. The efficiency and utility of this system is not very high.

For this reason, finally, the Public Authorities of each country had to promote and support the adoption of the soft Law by the companies. As it is indicated above, in some cases by enforcing some recommendations with compulsory rules,[103] or by the obligation to indicate in the annual report the reasons to not comply with the governance rules, under the risk to be punished if the reason is not duly motivated.[104]

Finally, regarding the hypothesis of regulating corporate governance by the contract of Corporate Group, the reality has also demonstrated (as happens in German regime) that the contract of group shall be improved itself. Currently, the majority of the groups are "de facto groups". The contract of the group could be the best way to regulate some issues that affect the governance of the group, but until the date, this option has not been successful.

- **Current achieved success**

[103] Specially, the transparency issues concerning the listed companies. For instance, the Spanish Royal Decree 1362/2007 of 19 October on transparency requirements in relation to information regarding issuers which securities are listed in an official secondary market

[104] For instance, in the Spanish Law 26/2003 of 17 July, article 116, concerning the annual corporate governance report issued by listed companies.

Nevertheless, several positive points can be assessed of the soft Law concerning corporate governance. Firstly, thanks to the international development of principles of corporate governance, such as OECD principles, there is global homogeneity in the basic guides of all the countries. In a global market, this fact is very relevant, and it would be nearly impossible to achieve by compulsory measures.

Secondly, soft Law is very flexible. The companies can always not follow the recommendations, if they motivate this not-compliance. In this way, the companies can adapt the guides to its own necessities, size of the company, the shareholders´ structure or the specific sector requirements. In this sense, over-strict and over burdensome rules are avoided by small companies. Additionally, the rules can change rapidly with the circumstances.

Finally, companies are supposed to be more responsible and cooperative if they decide to follow or not a governance guide by themselves. The own company will establish its own objective regarding the corporate governance issues. Consequently, there is a broad support to the "comply or explain" approach, as it is demonstrated by the Study on Monitoring and enforcement practices in Corporate Governance in the Member States of 2009.[105]

5. THE PROPOSED SOLUTION

5.1. Justification for regulation

The proposed solution is the creation of a proper, coherent, and competitive regulation for Corporate Groups. This regulation should maintain the basic definitions and guidelines concerning corporate governance issues. The idea behind this whole essay is that company Law cannot deal only with individual companies, under and entity approach; and corporate governance cannot be only located in listed companies.

There is no doubt that Corporate Groups exist and they are legitimate. In this sense, the exercising of a unit of direction, even the control by one company over the others is legitimate. Nevertheless, the exercise of this unit of direction must be ruled and submit to the good faith principles and loyalty duties of the shareholders and the directors.

[105] Available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf

Therefore, the needed regulation should articulate a balance between the unit of the group and the autonomy of the members of the group; and provide a balanced solution for the conflict of interests, the liability of the parent company and its directors for the acts and debts of the subsidiaries. Additionally, this regulation should provide a basis for the establishment of a corporate governance regime for this type of operator. The globalization of the markers is increasingly demanding a transparent and reliable environment. An appropriate corporate governance regime can bring benefits for the Corporate Group, such a good reputation in the market and a better knowledge of the own group, which allows to take better informed decisions.[106]

In addition, the recent financial crisis has also shown the necessity to reinforce the regulation and supervision of the Corporate Group´s activity and governance, also in a European level. The use of simple solutions and the recurrence of lifting the veil theories in order to pursue accountability is not the most adequate way to deal with the problems that arise from the activity of Corporate Groups. A clear regime should be established in order to ensure the legal certainty.

5.2. Different methods of regulation

In order to establish a coherent Corporate Groups' regime, an enterprise approach must be followed, moving away from the traditional strict entity Law. This change will reflect the current economic reality.

Additionally, it is necessary to chose between regulate the Corporate Groups by the establishment of general principles and standards, or by the establishment of detailed rules. Under the point of view of the legal certainty and the protection of the different interests involved in the group, detailed rules would be more recommendable in order to deal with all the issues that arise with Corporate Groups' existence and operations.

Nevertheless, the figure of the Corporate Groups would rather not admit a strict legal regime because they have highly complex and very different types of organization and structure. In this sense, the regulation by principles, without dealing with very specific issues appears as the best solution in order to achieve a flexible regulation, adequate to

[106] WAGNER, S. and DITTMAR, L. *The unexpected benefits of Sarbanes-Oxley.* Harvard Business Review, 84(4), pg.133

the current fast-changing economic reality.[107] This flexibility should also be reflected in the balance between mandatory rules and autonomy of the companies.

5.2.1. Balance between mandatory rules and autonomy of the companies.

The proposed solution is a balance between mandatory and voluntary rules. Mandatory guidelines and principles shall be settled, and the Corporate Groups shall develop those rules according to their concrete circumstances by voluntary rules. On one hand, as it was mentioned above, auto-regulation has failed in its practical application. On the other hand, mandatory and detailed regulation concerning Corporate Groups leaves many gaps concerning the cases that fall outside the scope of the scenarios envisaged in the Law.[108] Consequently, a flexible regime that combines both models of regulation may be the solution.

The regulation of the Corporate Groups is in the field of the Private Law, and then the party autonomy principle should have a relevant place in this matter. This party autonomy shall develop into the limits of the legal guidelines established by Law. The advantages of this approach will lead to a higher transparency of the structure and relationships into the group, by the incorporation and disclosure of the contract of group. The governance of the Corporate Group under this scheme will provide an image of seriousness.

Nevertheless, in order to protect the legitimate interests those are affected in the incorporation of a group, and because of demonstrated failures of the exclusively voluntary rules, some mandatory principles must be established by Law, with an appropriate control system and disciplinary regime that contemplates the eventual infringement of this regime.

5.2.2. Distribution of competences between interested parties.

Firstly, the regulation should avoid the two extremes: nor granting an absolute priority to the group´s interest to the detriment of the member companies, neither only recognizing the interest of each individual company, overlooking the legitimate interest of the group. Therefore, it will be necessary to respect the interest of the group, and the

[107] This is the point of view followed by the Forum Europaeum, as well as by the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union
[108] For instance, the gaps referred in the Portuguese and German regime for Corporate Groups.

legitimacy of the instructions of the parent company managing the group according to such interest, with the necessary protection and compensation (if appropriate) to the subsidiaries. The corporate governance of the groups and the general legal regime for groups should provide the solution for the referred conflict of interests.

The group should be incorporated by an agreement, which should be approved by all the member companies by a mechanism similar to the corporate structural changes, with the protective measures for minority shareholders. If the group already existed and was formed by other mechanism, the later redaction of the contract of group should be bound by the Law. This contract would declare the existence of the group, and would provide the transparency and external control that require this reality.

In this sense, in the incorporation of a Corporate Group, the distribution of competences and the way to govern the group must be provided. The distribution of the decision-making competences should protect the interests of the group and also include a greater or lesser individual autonomy of the member companies. The regime should provide enough protective measures for the member companies, its shareholders and stakeholders, but without undermining the economic operation unit of the group. To this purpose, minimal adequate compensation measures should be established by Law.

The General Meeting of Shareholders of the parent company should be granted with the power to modify the legal and economic structure of the group. In this way, the General Meeting should be the only managing body entitled to change the purpose of the group, and make structural and organizational changes into the group. The directors of the parent company should legally hold on the power to exercise the unit of direction of the group, with consequences in terms on liability.

Additionally, protection, information and voice rights, jointly with compensation measures should be granted to minority shareholders and subsidiaries' shareholders. The protection of stakeholders should be established by a liability regime laid down in the contract of the group. In this sense, in the contract should be clearly established and divided the responsibilities of the different members and managers, according to the structure of the group. Obviously, a centralized group cannot have the same liability system that a decentralized group. In this division of responsibilities, no stakeholder can

left unprotected, under penalty of jointly shared responsibility of all of the members established by Law.

When groups were established by Law, they would acquire the advantages of the Corporate Group's regime, but also the responsibilities. The current liability of directors in fact, established by the case Law with some legal uncertainty would lead to a safer legal trade. In this sense, the governance regime for groups could establish a clearer list of duties and rights.

Under the organizational point of view, some mechanisms should be provided in order to facilitate the communication between the members of the groups and set a transparent structure. This is the needed structure to achieve fair agreements into the group that give security to shareholders and stakeholders. In addition, the disclosure of such structure and agreements must be mandatory by Law.

All these issues should be provided in a contract of group. This contract should be registered and available for the market. Here, we are opting for the contractual group typology. In order to promote the legalization, registration and disclosure of the Corporate Groups, the factual groups should be discouraged, in the way of acquiring the liabilities but not the advantages of Corporate Groups' regime.

The legal mandatory guidelines and principles should establish the framework for the group´s regime, and later, the Corporate Group chooses the better structure for its activity, lays down into the contract of the group its own corporate governance regime jointly. This will be the best way to recognize and regulate the reality of Corporate Groups and at the same time, protect all the interested parties and the market.

5.3. Possible direction to be taken by national regulations and by European Regulation

As is settled above, the states should regulate Corporate Groups as an independent matter, outside the general corporate Law. The reality has shown that the Corporate Groups present specific characteristics and problems that deserve a specific regulation. Additionally, this regulation should recognize the legitimate interest of the group, which could prevail over other member´s interest if it is compensated.

In this sense, those countries that have not regulated or even deny the existence of Corporate Groups as legal enterprises, could take example from the German and Portuguese regime. Nevertheless, these regimes are not perfect. They create some gaps that need be fulfilled by flexible rules. In this sense, the balance between mandatory and voluntary and flexible rules is the most recommendable.

The alleged regime should include specifically more mandatory principles concerning the corporate governance of groups of companies. The contract of group would be a good instrument for the good governance of the group, if some compulsory issues were included in it, such as the transparency of the structure of the group, solutions to the conflicts of interests into the group, the distribution of rights and duties between the members and managers of the group or the duty to motivate the intra-groups agreements. This approach would set aside the principle "comply or explain". The only alternative should be to comply with the compulsory guidelines and explain the content and reasons of the specific rules voluntary laid down in the contract of group.

In a European Level, as it was pointed out above, the European Union has given up to regulate this issue. Nevertheless, the European Union should recognize in a binding text the legitimacy of the interests of the groups and establish some standards applicable in all the internal market concerning Corporate Groups. This could be the first step towards a homogeneous treatment of the Corporate Group issues in all the Member States. This point is relevant since lots of Corporate Groups are international and operates in several countries. Later, the Member States should develop and implement these principles and standards in the terms pointed out above. In this sense, the party autonomy would be respected also from the European perspective.

6. CONCLUSION

Corporate Groups have become one of the most important economic operators. Its existence and legitimacy cannot be nor denied, neither ignored. As it was stated above, Corporate Groups cannot be considered automatically fraudulent or to act in abuse of Law. The traditional entity approach model should be change into the enterprise approach model.

The gap between reality and Law cannot continue. The first step to protect the interests involved in Corporate Groups is recognizing the reality. Turning the back to this reality, and applying ad hoc solutions does not provide a certain legal environment.

In this way, Corporate Groups challenge to regulate harmonizing the different interests involved, in order to respond to the current reality of markets. In this sense, the legal plurality involved in this legal institution and the group's purpose should be recognized by Law and protected. The needed regulation should be flexible enough to cover all the typologies of groups, and all the problems that arrive with their activities and relationships. This objective has been stated in the European Winter Report, although it has not been achieved yet.

In this regulation, corporate governance of these economic operators should have a relevant space. Several issues concerning Corporate Groups are directly or indirectly connected with corporate governance.

The soft Law usually used to regulate corporate governance has demonstrated to be insufficient to protect the interests involved, and in the case of Corporate Groups this interests are more diverse and complex to balance. Consequently, the soft Law should change into a mandatory regime.

In this way, the proposed solution is regulating by principles, in a flexible and mandatory way. By a contract of group that would regulate the particularities of each group, but bound to the general principles. These principles should grant the necessary protection to all the parties involved in the activity of the Corporate Group. A complete regime of compensations, and liabilities should be established and be developed in each contract of group.

The objective is to recognize and regulate Corporate Groups and their governance, protecting all the interested parties and the market, in an effective and safe way, that provides the legal regime with enough legal certainty.

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